**Franchise Tax Board**

# SUMMARY ANALYSIS OF AMENDED BILL

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| Author: | Nakanishi | Analyst: | Jennifer Bettencourt | Bill Number: | AB 85 |
| Related Bills: | See Prior Analysis | Telephone: | 845-5163 | Amended Date: | February 27, 2007 |
| | | Attorney: | Daniel Biedler | Sponsor: | |

**SUBJECT:** Employer Provided Health Insurance Credit/FTB Report To Legislature On Or Before December 1, 2011 Regarding Usage & Effectiveness Of Credit

X DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced December 13, 2006.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

X FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 13, 2006, STILL APPLIES.

____ OTHER – See comments below.

## SUMMARY

This bill would create a tax credit for taxpayers that provide qualified health insurance for their employees.

## SUMMARY OF AMENDMENTS

The February 27, 2007, amendments would add definitional language for some previously undefined terms. In addition, the amendments added several co-authors. As a result of these amendments, the implementation considerations identified in the department's analysis of the bill as introduced December 13, 2006, have been resolved; however, others have been identified. Except for the "This Bill," "Implementation Considerations," and "Economic Impact" discussions provided below, the remainder of the department's analysis of the bill as introduced December 13, 2006, still applies.

## POSITION

Pending.

| Board Position: | | | Legislative Director | Date |
|---|---|---|---|---|
| ____ S | ____ NA | ____ NP | | |
| ____ SA | ____ O | ____ NAR | Brian Putler | 3/28/07 |
| ____ N | ____ OUA | X PENDING | | |

THIS BILL

This bill would allow a 15% credit for amounts paid or incurred during the taxable year by a taxpayer that provides qualified health insurance for its employees who perform services in California and pay income taxes to the state. The credit would be available for taxable years beginning on or after January 1, 2008, and before January 1, 2013, but is limited to three years total per taxpayer.

“Qualified health insurance” would mean:

- Amounts paid on behalf of employees to a High Deductible Health Plan (HDHP), or
- A Health Savings Account.

“Qualified taxpayer” would mean:

- Any new small to medium size employer, or
- Any existing small to medium size employer that has not provided health insurance to their employees during any of the five taxable years immediately preceding the taxable year.

“Small employer” would mean a person, as defined in Section 7701(a) of the Internal Revenue Code, or a private entity, employing at least 2 but not more than 19 persons.

“Medium employer” would mean a person, as defined in Section 7701(a) of the Internal Revenue Code, or a private entity, employing at least 20 but not more than 199 persons.

“New small to medium employer” would be defined as a small or medium employer created on or after October 1, 2008.

This bill would specify that no deduction would be allowed for the same expenses for which the credit was allowed and that any unused credits could be carried over to future years until the credit is exhausted.

This bill would require that on or before December 1, 2011, the Franchise Tax Board would provide a report to the Legislature to include the following:

- The total number of employees using the credit allowed under this provision,
- The total number of employees who have enrolled in high deductible health plans since the inception of the credit, and
- The total cost of this credit to the state.

This bill would further require that on or before March 1, 2012, the Legislative Analyst would provide a report on the effectiveness of the tax credit to the Legislature.

This bill would allow the credit to Personal Income Tax Law taxpayers, and Corporate Tax Law taxpayers.

IMPLEMENTATION CONSIDERATIONS

This bill would require that in order to qualify for the credit, services must be performed in this state and income tax must be paid to this state. It is unclear who is obligated to meet these requirements. Further, requiring that income tax is actually "paid" could result in disputes because some taxpayers have no tax liability. The author may wish to amend the bill to clarify whether the employer or employee must meet these requirements and eliminate or modify the "paid taxes to this state" criteria.

This bill would limit the credit to the first taxable year in which the credit is claimed and the succeeding two years, but allows an unlimited carryover. It is unclear whether the author intends to allow only a two year carryover, or if only new credits could be claimed during that period. Because the bill requires the taxpayer to "claim" the credit, taxpayers using carryovers may be unable to "claim" any new credit during the following two years, making them ineligible to receive the credit. The author may wish to amend the bill to minimize disputes between taxpayers and the department.

This bill would include any new small or medium employer created on or after October 1, 2008, as a qualified taxpayer. This could lead to disputes because all an existing employer would need to do to become "new" is change its form of business. In addition, a Limited Liability Company created from an existing sole proprietorship could also be argued as "new." The author may wish to amend the bill to include language similar to that contained in current Net Operating Loss provisions, which eliminate the potential for abuse.

**ECONOMIC IMPACT**

Revenue Estimate

This bill as amended would result in the following revenue losses:

| Revenue Impact Of AB 85<br>As Amended February 27, 2007<br>Enactment Assumed After June 30, 2007<br>($ in Millions) | | | |
|---|---|---|---|
| | 2007-8 | 2008-9 | 2009-10 |
| Revenue Impact | -$5 | -$24 | -$39 |

This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

This bill, as amended, has two new provisions with potential revenue impact. The first is the provision that "*a qualified taxpayer is only eligible for the credit allowed by this section for the first year in which the credit is claimed and for each of the two consecutive taxable years following the taxable year in which the credit is first claimed*." Since department revenue estimates generally include only the first three fiscal years of impact, to the extent that this provision would have a revenue impact, it would fall outside the budget window. Moreover, to the extent that most of the qualified taxpayers would take advantage of the credit starting in 2008, the revenue impact of this provision for fiscal years 2010-11 and beyond would be due to the remaining taxpayers that would provide health insurance to their employees for the first time. The revenue impact of this provision for these years, therefore, is expected to drop off significantly from the revenue impact originally estimated for the first three fiscal years.

Second, this bill, as amended, provides a new definition of a qualified taxpayer. The qualified taxpayer is defined as any new small to medium size employer, or any *existing* small to medium size employer that, during *any of* the five taxable years immediately preceding the taxable year, has not provided health insurance to employees employed by the employer in this state. With this provision, some small to medium size employers that failed to qualify under the bill, as introduced, would now qualify for the tax credit. For example, a small to medium size employer that provided insurance to its employees in four out of five preceding taxable years would now qualify for the credit. This would increase the number of employees working for the qualified employers.

The revenue for this provision reflects this increase. It is assumed that approximately 2.2 million employees would be working in qualified taxable small and medium size businesses in 2008. The remaining assumptions are the same as those used in the original estimate.

**LEGISLATIVE STAFF CONTACT**

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